



Signed: October 28, 2007

Leslie Tchaikovsky

LESLIE TCHAIKOVSKY
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

No. 06-42425 T
Chapter 11

DEAN GORDON POTTER,

Debtor.

REPORT AND RECOMMENDATION RE MOTION TO
WITHDRAW THE REFERENCE OF JURISDICTION
(Case No. 4-07-CV-074826 CW)

On September 7, 2007, the United States of America (the "IRS") filed a motion (the "Motion"), asking the United States District Court for the Northern District of California (the "Northern California District Court"): (1) to withdraw the reference of jurisdiction to the Bankruptcy Court with respect to certain tax disputes between the IRS and the above-captioned debtor (the "Debtor") pursuant to 11 U.S.C. § 157(d) and (2) to transfer the disputes to the United States District for the Eastern District of California (the "Eastern California District Court"). On October 2, 2007, the Northern California District Court referred the Motion to the Bankruptcy Court (the "Bankruptcy Case Judge") for a

I hereby certify that the foregoing document is a true and correct copy of the original on file in the Northern District of Calif.

Global Franklin, Clerk

U.S. Bankruptcy Court

Deputy Clerk

1 recommendation. For the reasons stated below, the Bankruptcy Case
2 Judge recommends that the Motion be granted.

3 DISCUSSION

4 The Debtor is the president and majority shareholder of UNICO.
5 Until 1998, the Debtor was also UNICO's key employee. However, in
6 1998, the Debtor entered into an arrangement that resulted in his
7 services being leased to UNICO by a third party entity. The
8 structure of the arrangement was such that, in theory at least, the
9 Debtor received only a portion of the compensation paid by UNICO for
10 the Debtor's services.

11 More precisely, the arrangement was as follows: The Debtor
12 entered into an employment agreement with an Irish corporation
13 entitled Pixley which assigned its rights in the Debtor to IESI, a
14 Barbadian entity. The agreement gave the Debtor the right to certain
15 fringe benefits, including a non-qualified deferred compensation plan
16 upon retirement (the "Retirement Plan"). IESI then subleased the
17 Debtor's services to ReleaseMe, a United States entity, which in turn
18 assigned its right to the Debtor's services to Fair Skys, another
19 United States entity. Finally, Fair Skys leased the Debtor's
20 services to UNICO. UNICO paid Fair Skys for the Debtor's services.
21 A portion of the compensation paid by UNICO for the Debtor's services
22 were paid to the Debtor, which the Debtor reported as income and on
23 which he paid federal income tax. A portion of the balance was
24 retained by ReleaseMe and Fair Skys as fees. The balance was paid
25 into the Retirement Plan.
26

1 The above-captioned chapter 11 bankruptcy case was filed on
2 December 12, 2006. On April 9, 2007, the Debtor filed an adversary
3 proceeding against the Internal Revenue Service (the "IRS") in the
4 United States Bankruptcy Court for the Northern District of
5 California, A.P. No. 07-4066 AT (the "Bankruptcy Court Action"),
6 seeking an income tax refund for the tax year ending December 31,
7 1998. On May 29, 2007, an entity entitled UNICO Services, Inc.
8 ("UNICO"), filed an action in the United States District Court for
9 the Eastern District of California (the "District Court Action"),
10 seeking a refund of employment taxes on the amount that UNICO paid
11 for the Debtor's services. The IRS filed a timely proof of claim on
12 June 6, 2007. The Debtor filed an objection to the IRS claim on June
13 28, 2007 (the "Objection to Claim").

14 The dispute presented by the Bankruptcy Court Action and
15 objection to claim is whether the Debtor is obligated to pay income
16 tax only on the portion of the compensation that he received directly
17 from UNICO or also on the portion paid into the Retirement Plan. The
18 dispute presented in the District Court Action is whether UNICO is
19 required to pay withholding taxes on the compensation paid for the
20 Debtor's services even though UNICO has not been allowed to claim
21 this compensation as a salary deduction. The Debtor contends that
22 the issues presented in the District Court Action are different from
23 those presented in the Bankruptcy Court Action and Objection to
24 Claim. However, they all turn on whether, notwithstanding the
25 leasing arrangement described above, the Debtor should still be
26 characterized as an employee of UNICO. Judicial economy would best

1 be served by having one court hear all matters. Since the Debtor is
2 not a party to the District Court Action, it is more appropriate for
3 the matters to be consolidated in the district court than in the
4 bankruptcy court.

5 Section 157(d) of Title 28 of the United States Code permits the
6 District Court to withdraw the reference of bankruptcy jurisdiction,
7 in whole or in part, with respect to any case or proceeding pending
8 in the Bankruptcy Court, either on its own motion or on a timely
9 motion of any party, for cause shown ("Permissive Withdrawal"). It
10 requires the District Court to withdraw the reference, on timely
11 motion of a party, if resolution of the proceeding requires
12 consideration of both Title 11 and other laws of the United States
13 regulating organizations or activities affecting interstate commerce
14 ("Mandatory Withdrawal"). Because both Permissive and Mandatory
15 Withdrawal require a motion by a party to be timely, the timeliness
16 of the Motion is the first issue to be addressed.

17 **Timeliness of Motion to Withdraw**

18 The Debtor contends that the Motion is not timely because it was
19 not filed until nine months after the bankruptcy petition was filed.
20 The Debtor cites cases in which courts have concluded that motions
21 filed after similar periods of time were untimely. See, e.g., Laine
22 v. Gross, 128 B.R. 588, 589 (D.Me. 1991) (motion filed more than six
23 months after complaint filed untimely); Hupp v. Educ. Credit Mgmt.
24 Corp., 2007 WL 2703151, *4 (S.D. Cal. 2007) (motion filed more than
25 fifteen months after complaint filed untimely); but see Burger King
26 Corp. V. B-K of Kansas, Inc., 64 B.R. 728, 731 (D. Kan. 1986) (motion

1 granted although filed ten months after filing of counterclaim upon
2 which motion to withdraw was based).

3 The IRS contends that the time should run not from date of the
4 filing of the bankruptcy petition but from the date of the filing of
5 the Objection to Claim. The Motion was filed a little more than two
6 months from this date. Alternatively, the time might be considered
7 to run from the date of filing the complaint in the Bankruptcy Court
8 Action. The Motion was filed approximately five months from this
9 date.

10 The Bankruptcy Case Judge agrees with the IRS that the time
11 elapsed should not be counted from the petition date. The IRS is not
12 moving to withdraw the reference of the bankruptcy case in its
13 entirety nor would the Bankruptcy Case Judge recommend that the
14 reference of the entire case be withdrawn. A chapter 11 debtor has
15 various procedural and substantive obligations which the Office of
16 the United States Trustee (the "UST") and the court must monitor.
17 It would not make sense to impose these burdens on a district court.

18 Thus, at most the time elapsed in filing the Motion is five
19 months. Although close to the six month delay found to be excessive
20 in Laine, it is substantially less than the ten month delay found to
21 be *just barely* acceptable in Burger King. Moreover, case authority
22 shows that timeliness is not to be viewed in a vacuum.

23 The reason for the requirement of a timely motion is presumably
24 twofold: (1) to avoid disrupting an ongoing proceeding in which the
25 judge has already become familiar with the issues with a resulting
26 delay and duplication of effort; and (2) to prevent parties from

1 using such motions as a litigation strategy when they do not like how
2 things are going in the original forum. Neither reason would be
3 served by denial of the Motion. Nothing of a substantive nature has
4 occurred in the bankruptcy court with respect to the Debtor's
5 disputes with the IRS, either in connection with the Objection to
6 Claim or the Bankruptcy Court Action. In fact, the IRS has not even
7 filed an answer to the complaint in the Bankruptcy Court Action.¹
8 Thus, the Bankruptcy Case Judge recommends that the District Court
9 find that the Motion is timely.

10 **Withdrawal of the Reference**

11 As noted above, withdrawal of the reference is mandatory if the
12 disputes raise issues of both bankruptcy law and other federal law
13 affecting interstate commerce. Case law has interpreted this
14 requirement as limited to substantial and material issues of other
15 federal law. Withdrawal is not mandatory if the nonbankruptcy issues
16 are governed by well settled law. See In re White Motor Corp., 42
17 B.R. 693, 705 (N.D. Ohio 1984); In re Columbia Gas Systems, Inc., 134
18 B.R. 808, 811 (D. Del. 1991).

19 The Debtor contends that the tax issue presented here is not
20 substantial or material.² The IRS disagrees. The Bankruptcy Case
21 Judge agrees with the IRS. Clearly, the multi-tiered arrangement
22 renders the disputes factually complex. Moreover, the Debtor
23

24 ¹ The parties stipulated that the IRS could delay filing an
25 answer until August 23, 2007. However, to date, for reasons that
26 are not apparent, no answer has yet been filed.

² He does not appear to argue that the dispute does not
require consideration of laws affecting interstate commerce.

1 contends that the arrangement was structured by competent tax
2 lawyers. The Court assumes that, if the law governing such
3 arrangements was well settled, a competent attorney would not have
4 structured a transaction in this fashion. Whether an employee
5 leasing arrangement whereby a portion of the compensation is paid
6 into a non-qualified retirement plan constitutes legitimate tax
7 planning or a sham transaction constituting tax evasion appears to be
8 a novel issue. Clearly, the issue has ramifications beyond this
9 bankruptcy case. It seems inappropriate for the issue to be
10 addressed in the first instance by a bankruptcy court, particularly
11 where the bankruptcy case appears to have been filed for forum
12 shopping purposes.

13 Moreover, even if the nonbankruptcy federal issue were not
14 deemed material and substantial, for the reasons stated above,
15 permissive withdrawal appears appropriate. There is a danger of
16 inconsistent determinations if two different courts decide whether
17 the Debtor should be characterized as UNICO's employee despite the
18 employee leasing arrangement. Judicial economy would also best be
19 served by a single court addressing that issue. There is no
20 prejudice to the bankruptcy case from withdrawal of the reference as
21 there is no ongoing activity in the case of any substance other than
22 the tax disputes and time does not appear to be of the essence in
23 resolving the disputes.

24 **Transfer of the Proceedings to the Eastern District**

25 The Bankruptcy Case Judge also recommends transferring the
26 Bankruptcy Court Action and the Objection to Claim to the Easter

1 District Court. Judicial economy would best be served and
2 inconsistent determinations avoided by consolidating the Eastern
3 District Court Action with the Bankruptcy Court Action and Objection
4 to Claim. While consolidation could also occur in the Northern
5 District Court, the Debtor chose the Eastern District Court as a
6 forum on behalf of UNICO and the IRS has indicated that it has no
7 objection to litigating all matters there.

8 **CONCLUSION**

9 The Bankruptcy Case Judge recommends that the Northern District
10 Court:

- 11 1. Find that the Motion is timely;
- 12 2. Conclude that the Motion to withdraw the Objection to Claim
13 and the Bankruptcy Court Action is either required or should be
14 granted as a matter of discretion; and
- 15 3. Grant the Motion to transfer the Objection to Claim and the
16 Bankruptcy Court Action to the Eastern District Court and assigned to
17 the same judge presiding over UNICO Services, Inc. v. United States;
18 case no. 2:07-CV-01009-MCE-KJM.

19 **END OF DOCUMENT**
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COURT SERVICE LIST

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